IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 133

JOHN H. CHATZ, TRUSTEE IN BANKRUPTCY OF HOAGLAND & ALLUM CO., INC.,

Petitioner,

vs.

MIDCO OIL CORPORATION, A CORPORATION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

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INDEX.

Subject Index.

PAGE

Table of Cases Cited.

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To the Honorable the Justices of the Supreme Court of the United States:

The petition of John H. Chatz, Trustee in Bankruptcy of Hoagland & Allum Co., Inc., prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit which affirmed the findings and judgment of the District Court of the United States for the Northern District of Illinois, Eastern Division, dismissing petitioner's complaint against the respondent, Midco Oil Corporation, at this petitioner's costs.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The petitioner is the Trustee in Bankruptcy of Hoagland & Allum Co., Inc., a stock brokerage concern which operated on La Salle Street, in the City of Chicago, for many years before it was adjudicated a bankrupt, on April 14, 1938. Shortly after the adjudication in bankruptcy, the officers of the bankrupt company were prosecuted and convicted under Federal and State charges for various wrongs committed against its customers in converting and hypothecating their respective securities. The total defalcations amounted to approximately $500,000.00 (Rec. 210).

About the time these officers were scheduled to be released from their incarceration, the Trustee filed his complaint against them and others for discovery of assets and accountings. As the result of disclosures thus obtained, the respondent, Midco Oil Corporation, was made a party defendant (Rec. 8), and a supplemental complaint for discovery of assets and for accountings was thereupon filed against said respondent (Rec. 9). The respondent is a Delaware Corporation licensed to do business in Oklahoma and maintains its head office in Tulsa, Oklahoma.

Briefly stated, it is charged in the supplemental complaint (Rec. 9-14), that during the month of August, 1937, the bankrupt stock broker had carried on a series of negotiations with one Roy Mead, a resident of Tulsa, Oklahoma, with the view of having him acquire the majority of the outstanding stock of the respondent, Midco Oil Corporation, at the price of $43.00 per share; that bankrupt circularized its list of customers who were owners of Midco Oil Corporation stock urging them to make deposit of their respective shares with a designated depository, for that purpose. In consequence of such circularization some stock-

holders sent their certificates of stock to the depositary; however, a number of bankrupt's customers brought their shares to the bankrupt for that purpose, with the result that 2,000 shares of this stock belonging to its customers came into or was then in the bankrupt's possession. The complaint further charges that in consequence of secret negotiations which were then undertaken and carried on between the officers of the bankrupt and this respondent, the said respondent, on September 3, 1937, fraudulently purchased from the bankrupt the said 2,000 shares of respondent's capital stock, the property of its stockholders (Rec. 12), at the price of $33.50 each share, or a total sale price of $67,000.00; that after the payment of $2,000.00 to the respondent's intermediary in this transaction, the balance of $65,000.00 was transmitted and paid over to the bankrupt, who converted the proceeds. The supplemental complaint further charges that this respondent then had full knowledge of the bankrupt's communications and negotiations with respondent's stockholders, and of the contemplated sale of the controlling stock to Roy Mead at $43.00 each share, that it made no inquiry as to the bankrupt's authority to make said sale to this respondent, nor did it make inquiry from any of the said stockholders as to the bankrupt's authority to sell their respective shares of stock, and that the conduct of the respondent in thus purchasing these shares of stock is therefore tantamount to fraud (Rec. 12). This supplemental complaint prayed that the Court find and adjudge the acts and conduct of this respondent in purchasing the said 2,000 shares of its corporate stock to be fraudulent and illegal and that this respondent be decreed and directed to pay over to plaintiff, as such Trustee in Bankruptcy, the actual value of these 2,000 shares of stock, together with legal interest from the date of such fraudulent purchase. This sworn supplemental complaint also contains a prayer for general relief (Rec. 14).

The unsworn answer of this respondent (Rec. 30-35) admits that it is a Delaware Corporation with its principal place of business in Tulsa, Oklahoma, and admits the purchase of these 2,000 shares of its capital stock (Rec. 31), through Mr. Lahman, the same intermediary in Tulsa, Oklahoma, as charged in the complaint (Rec. 32), but states that in the making of said purchase it was "in the exercise of due care, caution and diligence" (Rec. 33). The respondent further avers that its purchase was effectual under The Stock Transfer Act of Illinois and under the pertinent laws of Oklahoma (Rec. 34). A number of factual matters are pleaded in the answer to negative the charge of fraud, and a number of technical defenses are alleged which are not deemed pertinent at this time. This respondent admits in its answer that after it purchased these 2,000 shares of stock, it cancelled these shares and issued a new certificate of 2,000 shares to itself, in its own name (Rec. 35).

The dispute in this record turns on the legal effect of this stock purchase, the purpose therefor and the circumstances surrounding the purchase of these shares of its capital stock, although there is no controversy that this stock purchase was made by the respondent from the bankrupt at the time, for the price and substantially in the manner as charged in the supplemental complaint. The only corporate authority for making this purchase, which respondent produced, is a resolution passed at a special meeting of its Board of Directors, held at Tulsa, Oklahoma, on August 14, 1937, under and by which the Board of Directors authorized the corporation "to purchase as much as 5,500 additional shares of the outstanding stock of the Midco Oil Corporation for The Corporation. This stock to be obtained at the present market price which is from $28.00 to $35.00 per share. This stock after purchasing, is to be put in The Treasury of the Company and known as Treasury Stock" (Rec. 303). The secret letter

of instructions which were given by Mr. Lahman, the respondent's intermediary, to the bank which received and turned the stock over to respondent, is in the record (Rec. 386). Mr. Toomey, respondent's president (one of the three members of its Board of Directors) was at the bank when this letter of instructions and the checks for $67,000.00 were turned over to an officer of the bank (Rec. 247).

The record discloses that a short time before this sale, Henry A. Engel, the bankrupt's secretary, fraudulently transferred 1400 shares of this stock into his name (Rec. 205, 207, 301), and that he made loans on the collateral of this stock (Rec. 371, 374, 375, 376, 377). Engel admitted that these stocks belonged to customers of the bankrupt (Rec. 206); the Court accordingly found that substantially all of these shares of stock belonged to customers of the bankrupt and that they received none of the proceeds of this sale (Rec. 427).

The record further discloses that the respondent then had issued and outstanding a total of 36,575 shares (Rec. 240). Mr. Toomey negotiated for this stock purchase (Rec. 239). Toomey testified that his salary as President of this company had been materially increased, that he then owned approximately 2,500 shares of this stock and that he did not want the Mead deal to go through (Rec. 244). Toomey admitted that he received a copy of the circular letter sent out by the bankrupt to respondent's stockholders requesting deposits of stock for the purpose of the Mead deal (Plaintiff's Ex. 68, Rec. 319), and that he countered this by immediately sending out his letter to the stockholders urging them not to deposit their stock (Plaintiff's Ex. 73, Rec. 325). Toomey further admitted that in answer to an inquiry by one of the owners of several certificates of stock which were included in this purchase, he sent a reply which contained misinformation as to the identity of the purchaser of those shares of stock (Rec. 259, 353). Toomey

further testified that he did not inform the stockholders of this purchase (Rec. 260).

The Circuit Court of Appeals in affirming the District Court held that petitioner is precluded from relying upon the Oklahoma Statute which specifically prescribes the circumstances and manner for purchasing its capital stock by the issuing corporation; that the respondent and its officers did not owe a fiduciary duty to its stockholders whose shares it had thus purchased, and the Court treated this purchase as falling within the protection of the Uniform Stock Transfer Act. The Circuit Court of Appeals did not review the record *de novo,* but accepted the findings as made by the District Court, despite the fact that this is an equity proceeding.

There was no unanimous consent or other authorization by the respondent's stockholders to make the purchase in question and no resolution or other writing to that effect was ever presented to the stockholders; in fact no unanimous written consent of its stockholders to make this purchase, as the Oklahoma statute requires, was ever procured. The record discloses from the testimony of Mr. Toomey, the president of the respondent company, that the $67,000.00 which paid for the stock and the intermediary's brokerage came from the respondent's operating capital (Rec. 227). The respondent then had no surplus capital, but on the contrary, it had a very substantial deficit; this appears from the two financial reports introduced into evidence by the respondent as its Exhibits 62 and 63 (Rec. 387, 397). These exhibits disclose that respondent's deficit on December 21, 1936, before this purchase, was $954,696.71 (Rec. 392) and on December 31, 1937, after it made this purchase of stock, its deficit was $862,379.52 (Rec. 398). Under these established circumstances, as it will presently be shown in the brief following, the controlling statutes of Oklahoma and Delaware were clearly violated by the respondent; the transaction under discussion is therefore *ultra vires,*

and should have been so adjudicated by the Circuit Court of Appeals.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is reported in 152 F. (2d) 153, and appears at pages 447 to 451 in the record.

STATEMENT AS TO JURISDICTION.

The judgment of the Circuit Court of Appeals was entered December 1, 1945 (Rec. 452), rehearing denied January 5, 1946 (Rec. 371). The jurisdiction of this Court rests on Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C.A. Section 347).

QUESTIONS PRESENTED.

1. Should not the Circuit Court of Appeals have taken judicial notice of the respective statutes which control the right of the respondent as the issuing corporation, to purchase its capital stock, and which specifically defines the limited conditions under which such purchase can be made?

2. Is it not the duty of a Court of Equity to rigidly enforce paternalistic statutes which govern, define and prescribe the circumstances and manner of making purchases of its capital stock by the issuing corporation?

3. Was not the respondent as the purchasing corporation required to affirmatively establish its compliance with the statutes of the state of its creation (Delaware), as well as of the state in which it does business and where it consummated the purchase of this stock (Oklahoma), which statutes regulate such purchases of capital stock?

4. Can the respondent ignore the statutes which regulate the manner of making stock purchases by the issuing corporation and at the same time be permitted to prevail

under its defense that it acted with "diligence" and in "good faith"?

5. Were the provisions of the Uniform Stock Transfer Act of Illinois properly applied by the Court as a defense to this purchase which is admitted to have been consummated in Oklahoma by a Delaware Corporation, in preference to the applicable statutes of those states?

6. Did not the respondent and its officers owe a fiduciary obligation to its stockholders not to buy their stock certificates secretly, in violation of the statutes and established law, but to zealously protect them and their interests in their stock in any manner reasonably possible; and does not an obvious breach of such duty create an obligation on the corporation to repay to the stockholders the loss thus sustained by them?

7. Disregarding the fiduciary relationship which existed between the parties, does not the common law rule apply in a state which has not adopted the Uniform Stock Transfer Act, so that the owners of endorsed stock certificates which have been stolen can recover them or their value, even though the one in possession of such stock certificates may appear to be a bona fide purchaser for value, without notice of the existing infirmities in title?

8. Was not the disrupting of the then contemplated plan to sell the controlling interest in this corporation to Roy Mead and to thereby retain control thereof for Toomey, its president, the real purpose for making this secret, illegal and unconscionable stock purchase?

9. Does not the misleading reply which Toomey sent to the owner of several certificates of this secretly purchased stock, shortly after its acquisition, establish strong evidence of wrongful knowledge on his part, at the time of purchase, which is imputed to the corporation?

10. Did not the respondent's purchase of this stock from the bankrupt at the price of $32.50 each share with knowl-

edge that its stockholders were then being urged to deposit their stock for sale at $43.00 per share constitute notice or knowledge that the bankrupt had no authority to sell its customers' stocks at a substantially lesser price, and that such notice prevented the respondent from acquiring indefeasible title to this stock?

11. Does not the fact that within about eight days after the respondent corporation cautioned its stockholders in writing not to deposit their shares of stock in connection with the Mead deal, it nevertheless undertook to negotiate with the bankrupt for the purchase of this block of stock, *ipso facto* establish a *prima facie* case of fraud in intent, purpose and in the consummation of this purchase?

12. Does not an appeal in an equity proceeding necessarily result in a trial *de novo* on the whole record, in the Circuit Court of Appeals, and in this Court?

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Circuit Court of Appeals is based upon a misinterpretation and misapplication of this Court's decisions in *Securities and Exchange Com.* v. *Chenery Corporation*, 318 U. S. 80, and *Pepper* v. *Litton*, 308 U. S. 295.

2. The Circuit Court of Appeals failed to take judicial notice of and give due effect to Sec. 19, Chapt. 65 of the Revised Code of Delaware, and Sec. 58, Title 18 of the Statutes of Oklahoma, which statutes define the manner, purpose and circumstances under which respondent could purchase its shares of capital stock.

3. The Circuit Court of Appeals failed to give due effect to applicable and controlling state statutes, statutory provisions and established common law principals and the supporting decisions of Courts of review which define the rules determining the disposition of this character of proceeding.

4. In failing to find and determine the existence of a fiduciary relationship between the respondent and its stockholders whose shares of stock it thus purchased from the bankrupt, and in failing to hold that the respondent and its president violated such duties to its stockholders in making this secret purchase, which violation of duty consequently voided this purchase, the decision of the Circuit Court of Appeals is in conflict with the great weight of authority.

5. In failing to recognize its obligation to try this equity cause *de novo* on the entire record, the Circuit Court of Appeals departed from the accepted and usual course of judicial proceedings as outlined by this court in *Keller* v. *Potomac Electric Co.*, 261 U. S. 428 (at page 444), 43 S. Ct. 445, 449, 67 L. Ed. 731.

WHEREFORE, your petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court for review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in Cause No. 8679, entitled "*John H. Chatz, Trustee in Bankruptcy of Hoagland & Allum Co., Inc., Plaintiff-Appellant* v. *Midco Oil Corporation, a corporation, Defendant-Appellee*", and that the said order and judgment of the United States Circuit Court of Appeals for the Seventh Circuit may be reviewed and reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

JOHN H. CHATZ, Trustee in Bankruptcy
of Hoagland & Allum Co., Inc.,
Petitioner,

By: WILLIAM S. KLEINMAN,
Counsel for Petitioner.

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STATEMENT OF THE CASE.

A statement of the matter involved has been fully presented in our petition and the Court is respectfully referred to pages 2 to 7 herein. In the interest of brevity the statement is not repeated here.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals for the Seventh Circuit erred in the following respects:

1. In determining that the sale of the stock in question was valid.

2. In failing to take judicial notice of the statutes of Delaware and Oklahoma regulating the purchases of its capital stock by a corporation subject to the laws of those states, and in failing to apply and enforce said statutes as applicable to this proceeding.

3. By failing to determine that said purchase of stock by the respondent was contrary to law, *ultra vires* and void.

4. By failing to hold that the respondent corporation and its president owed to the owners of said stock the fiduciary obligation not to injure their property rights in said stock and not to purchase said shares of stock in violation of such duty.

5. In holding that no fiduciary duty was owed by the president of the respondent corporation to the stockholders when making said purchase.

6. In adjudicating that said stock purchase was valid under the Illinois Uniform Stock Transfer Act and under the laws of Oklahoma.

7. By failing to apply the common law rule to this transaction which makes the shares of stock in question recoverable by petitioner on behalf of the true owners thereof.

8. By deciding this case contrary to the weight of authority and the established rules of law and equitable principles applicable thereto.

9. By failing to reverse the judgment of the District Court, as is justified by the facts, equitable principles and the law applicable thereto.

SUMMARY OF ARGUMENT.

I.

The Circuit Court of Appeals was obliged to take judicial notice of the statutes of Delaware and Oklahoma and to decide this case in conformity with the requirements of those statutes.

II.

By virtue of the statutes of Delaware and Oklahoma the purchase of capital stock by the issuing corporation could be accomplished only out of surplus profits or by the unanimous written consent of the respondent's stockholders. As this purchase was made without the unanimous written consent of the stockholders and actually without any notice to them, and was paid for with operating capital while the corporation had an admitted deficit of almost a $1,000,000.00, the purchase was contrary to the statutes, in violation of public policy, and was *ultra vires* and void.

III.

The Circuit Court of Appeals failed to note the factual distinctions between this case and *Securities and Exchange Com.* v. *Chenery Corporation,* 318 U. S. 70, in citing that case as authority for its erroneous conclusion that no fiduciary relationship then existed between the respondent and its stockholders which would bar the respondent from making this purchase from the bankrupt. The transaction here under attack could not be regarded as bona-fide or valid under any accepted rule of law, for the purchase

was accomplished in a surreptitious manner, through an intermediary and at a price substantially less than was known to have been communicated to the stockholders, with knowledge of the fact that the stockholders were being urged to deposit their stock for sale to Roy Mead at a higher price, and this purchase was made for the sole purpose of interfering with that transaction so as to protect the president's position in the respondent's company, with no thought given to the essential statutory requirements and the rights of the stockholders whose shares of stock the respondent was thus purchasing.

As a fiduciary, the respondent had the burden of proving fair dealing towards its stockholders, and a valid purchase, in accordance with all legal requirements; this it failed to do and the Circuit Court of Appeals was obliged to hold that it failed to maintain its defense.

IV.

As the Uniform Stock Transfer Act of Illinois has no extraterritorial application, that statute cannot be urged as a defense to this void sale of stock of a Delaware corporation which was consummated in the state of Oklahoma, where neither Delaware nor Oklahoma has adopted such an Act, so that this statute obviously could not apply to this purchase. In the states of Oklahoma and Delaware the common law rule must necessarily prevail which protects the true owner of stock from loss thereof by theft, even though the shares of stock had been found in the hands of a bona fide purchaser, which the respondent was not. The Circuit Court of Appeals should have reviewed the entire record and should have held this rule to be applicable to the facts in this case and consequently should have awarded recovery to this petitioner. The correct application of the Illinois statute to the facts in this case would, in any event, have required the Court to award recovery to this petitioner.

ARGUMENT.

I.

By virtue of the "Uniform Judicial Notice of Foreign Law Act" of Illinois, and the pronouncements by this Court, the Circuit Court of Appeals was required to take judicial notice of the statutes of Delaware, as well as the statutes of Oklahoma.

This court said in *Mills* v. *Green,* 159 U. S. 651, at page 657:

> "The lower courts of the United States and this court, on appeal from their decisions, take judicial notice of the constitution and public laws of each state of the Union." (Citing cases.)

In *Adam* v. *Saenger,* 303 U. S. 59 (82 L. Ed. 649, 58 S. Ct. 454) this Court said at page 63:

> "Where they are in issue this Court, in the exercise of its Appellate jurisdiction to review cases coming to it from state courts, takes judicial notice of the law of the several states to the same extent that such notice is taken by the court from which the appeal is taken."

In *Loree* v. *Abner,* 57 Fed. 159 (C. C. A. 6), the court said on page 164:

> "The Federal Courts take judicial knowledge of the laws of the several states of the Union."

Wigmore on Evidence, Third Edition—Section 2573, page 556, states the rule as follows:

> "Since the judicial powers of the Federal Courts extend to many cases arising under the laws of the various States of the Union, such *State laws* are for

the purpose in hand part of the law of the *Federal Courts*, and will therefore be noticed by them."

Section 48g, Chapter 51, Illinois Revised Statutes 1945 provides as follows:

"(Judicial Notice) Every court of this state shall take judicial notice of the common law and statutes of every state, territory and other judisdiction of the United States."

This Illinois statute, which is the law of judicial notice of the forum, necessarily requires all the courts of that state to take judicial notice of the statutes of every state, and applies with equal force to the Federal Courts in that state and to courts of review, as announced in the authorities hereinabove quoted.

It is axiomatic that judicial notice of facts takes the place of proof and is of equal force; it displaces evidence since it stands for the same thing. The Circuit Court of Appeals was unquestionably required to take judicial notice of these statutes of Delaware and Oklahoma and clearly erred in failing to do so.

II.

The purchase of its capital stock by the issuing corporation in any manner other than as permitted by statute, is ultra vires and void.

Section 19, (2051) Chapter 65 of the Revised Code of Delaware provides that:

"Every corporation organized under this Chapter shall have the power to purchase, hold, sell and transfer shares of its own capital stock: Provided that no such corporation shall use its funds or property for the purchase of its own shares of capital stock when

such use would cause any impairment of the capital of the corporation, * * *."

The Circuit Court of Appeals for the Third Circuit construed a corporation's power under the above quoted Delaware Statute, in *Acker* v. *Girard Trust Co.*, 42 F. (2d) 37, where the court said on page 40:

> "The company has no surplus, and therefore, as a Delaware corporation, its powers are fixed by the laws of that state (citing Delaware Statute).
>
> "Construing such statute the Court of Chancery of Delaware held in *Re International Radiator Company*, 10 Del. Ch. 358, 92A 255, such stock purchases could only be made out of a corporation's surplus.
>
> "Moreover, this court, in *West Penn Chemical & Manufacturing Company* v. *Prentice*, 236 F. 891, 894, said:
>
> 'We think it our duty to follow this decision upon the construction and effect of the Delaware statute, and we find it a controlling authority in the present case.' "

In construing a similar restriction contained in the Statutes of West Virginia, Circuit Judge Northcott said in *United Thacker Coal Co.* v. *Peytona Lumber Co.*, 15 F. Supp. 40, at page 44:

> "The Trust Company [the seller] is charged with the knowledge of the law governing a corporation in the state in which it is incorporated, and therefore knew that, if the purchase of the stock impaired the capital of the corporation, it was in violation of the statute and *ultra vires*. *In re International Radiator Co.* 10 Del. Ch. 358, 29 A 255; *McCormick* v. *Market National Bank*, 165 U. S. 538, 17 S. Ct. 433, 41 L. Ed. 817, 3 Thompson on Corporations, Sec. 1795."

on page 45 the Court said:

> "The purchase of the stock was in violation of the statute, *ultra vires*, and consequently void."

Section 58, Title 18, of the Statutes of Oklahoma, is as follows:

> "A corporation may purchase, hold and transfer shares of its own stock, from its surplus profits, or by the unanimous consent in writing of all its stockholders, in such manner and for such price or consideration as the said stockholders may unanimously decide upon."

The Supreme Court of Oklahoma enforced these rules in *Capitol Hill Undertaking Co.* v. *Render*, 299 Pacific 854, where the Court said on page 859:

> "A corporation 'may purchase, hold and transfer shares of its own stock, from its surplus profits, or by the unanimous consent in writing of all its stockholders, in such manner and for such price or consideration as the said stockholders may unanimously decide upon.' Section 5329 C. O. S. 1921. There is nothing in this record to show any surplus profits or unanimous consent in writing of the stockholders either to purchase or hold shares of its own stock. The corporation was without authority of law either to purchase or hold the shares of stock belonging to the plaintiff * * *."

Section 44 of Article IX of the Constitution of the State of Oklahoma provides:

> "§ 44 (Foreign corporations subject to same restrictions and requirements as domestic corporations). —No foreign corporation shall be authorized to carry on in this state any business which a domestic corporation is prohibited from doing, or be relieved from compliance with any of the requirements made of a similar domestic corporation by the Constitution or laws of the State."

In *18 C. J. S.*, Sec. 399, page 940, the following pertinent rule is stated:

> "The requisite and validity of a transfer of corporate stock are governed by the law of the domicile

of the corporation, although the transfer is made in another jurisdiction; but where a state, as a condition of a foreign corporation doing business within the state, prescribes certain regulations with regard to the transfers within the state, the foreign corporation must conform to such regulations and is bound thereby." Citing, *London, Paris and American Bank* v. *Aronstein,* 117 Fed. 601.

The respondent failed to conform its conduct to the statutory requirements of either Delaware or Oklahoma, as it was legally bound to do; it clearly violated these statutes, in utter disregard of the rights of its stockholders. It should therefore not be permitted to retain the shares of stock which it obtained as the result of violations of law; such retention is contrary to public policy (*McCandles* v. *Furland,* 296 U. S. 140, 162).

III.

The corporation and its president owed a fiduciary duty to all of its stockholders to protect their stock interests from unlawful transfer. As the corporation is itself a fiduciary and was the purchaser of this stock, its obligation to affect a legal purchase, not in derogation of the rights of its stockholders, was thereby greatly increased.

This Court will note from the opinion of the Circuit Court of Appeals that it refused to recognize the existence of a fiduciary relationship between the corporation and Mr. Toomey, its president, towards the stockholders whose shares of stock were thus acquired by the corporation. This refusal to adhere to a basic and controlling principal of law springs from that Court's misapprehension of this Court's opinion in *Securities and Exchange Com.* v. *Chenery Corporation,* 318 U. S. 70, and the failure to recognize the clear factual distinctions between the *Chenery*

case and this case. In the *Chenery* case there was a controversy between the stockholders and the officers of that corporation as to the right of officers to purchase preferred stock of their corporation on the open market, while plans for reorganization were before the Securities and Exchange Commission, and the consequent legal effect of such purchases as respects their right to ratable participation in the new stock. No question of fraud, secretiveness or breach of duty was involved or even intimated in that case; as a matter of fact, the Commission found that "honesty, full disclosure, and purchase at a fair price" characterized the transaction. The controlling question in the *Chenery* case turned upon the right of corporate officers to openly purchase preferred shares of the corporation and to permit such stock to be converted into stock of the reorganized company on the same basis and in the same proportion as the preferred stock held by other stockholders. It was there urged that the fiduciary duty of these officers towards their stockholders was violated by such purchases, with the result that proportionate participation with other preferred stockholders should have been denied to them. This Court held that although it would insist upon scrupulous observance of the fiduciary obligations of the officers towards the stockholders, it would not impose upon officers and directors any fiduciary duty to its stockholders which precludes them merely because they are officers and directors from buying and selling the corporation's stock. Obviously, there is not the remotest resemblance between the *Chenery* case and the case at bar, either in the facts or in the controlling rules of law, for in this case the issuing corporation by the use of an intermediary, in a secret manner and not on the open market, at a substantially lower price, in violation of the statutes of the state of its creation as well as the state of its residence, and for the obvious purpose of interfering

with and nullifying the steps which had been undertaken to procure deposits of stock for the purpose of the Mead transaction, and thereby to allow Mr. Toomey to retain control of this corporation, purchased these 2,000 shares of stock with operating capital, while it then had no reserve capital but an admitted deficit of close to $1,000,000.00.

Under the circumstances disclosed in this record, both the corporation and its president owed to their stockholders the duty of utmost fidelity, integrity and candor, which they not only ignored, but deliberately violated. The decision of the Circuit Court of Appeals, in holding that under these facts no fiduciary obligation existed towards the stockholders, runs counter to basic principles of equity jurisprudence and to an unwavering line of pronouncements to the contrary, by this Court, and many other Courts of Review.

It is a well recognized rule of law that the charter of a corporation is a contract between the corporation and the state, between the corporation and its stockholders and between the stockholders with respect to each other. This necessarily imposes an obligation on the corporation to observe all legal and statutory requirements which may affect the property rights of the stockholders. This Court held in *Pepper* v. *Litton*, 306 U. S. 295, at page 306, that a director is a fiduciary, so is a dominant or controlling stockholder or group of stockholders, and that their powers are powers in trust. In *Twin-Lick Oil Co.* v. *Marbury*, 91 U. S. 587, this Court said, on page 590, in discussing the obligation of a director towards his stockholders:

> "If he should be a sole director, or one of a smaller number vested with certain powers, this obligation would be still stronger, and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality, and freedom from motives of selfishness."

In defining the circumstances which create the fiduciary relationship, this Court said in *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483, at page 492:

> "It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation."

In the *Restatement of the Law of Trusts,* Chapter 7 Sec. 170, page 432, the pertinent rule is stated as follows:

> "The trustee violates his duty to the beneficiary not only where he purchases trust property for himself individually, but also where he has a personal interest in the purchase of such a substantial nature that it might affect his judgment in making the sale."

A few of the many authorities supporting these rules are the following:

Wardell v. *R. R. Co.,* 103 U. S. 651 at page 658.

McCandles v. *Furland,* 296 U. S. 140, at page 162 (80 L. Ed. 121, 56 S. Ct. 41).

Holly Corporation v. *Wilson,* 101 Col. 513, page 519.

Hinckley v. *Sac Oil & Pipe Line Co.,* 132 Ia. 396 at pages 403, 404 (107 N. W. 69).

Wool Growers Service Corporation v. *Ragan,* 140 P. (2d) 512 at page 527 (18 Wash. (2d) 655).

Farwell v. *Pyle National Headlight Co.,* 280 Ill. 157 at page 164.

Dixmoor Golf Club v. *Evans,* 325 Ill. 612, at page 616.

Billings v. *Shaw,* 209 N. Y., 265 at page 282.

Oliver v. *Oliver,* 118 Ga. 362, at pages 367, 370, 371.

Allman v. *Salem Building Association,* 275 Ill. 336 at page 341.

Fletcher Cyclopedia Corporation, Vol. 12 Sec. 5539, at page 455.

IV.

This purchase of stock cannot be defended under the provisions of the Illinois Uniform Stock Transfer Act.

If the statutes and rules of law hereinabove cited had not been urged or relied upon, the sale of this stock could still have been challenged and could have been voided, and the shares of stock would be recoverable by the defrauded stockholders; this right of recovery stems from the prevailing common law rule which protects the true owner of stock from loss thereof by theft, even though the shares of stock were found in the hands of a bonda fide purchaser. The state of Oklahoma has not adopted the Uniform Stock Transfer Act and therefore, the common law rule applies to stock purchases in that state. Obviously, the Uniform Stock Transfer Act can have no extraterritorial application, and the decision in *United States Gypsum Co.* v. *Faroll*, 296 Ill. App. 47, which is based upon that Act, and is relied upon by the Circuit Court of Appeals in its decision, is wholly inapplicable and is no authority in this case. The correct rule is stated by the Supreme Court of Massachusetts in *Barstow* v. *City Trust Co.*, 216 Mass. 330, as follows, on page 333:

> "A certificate of stock issued by a corporation with a form of assignment and power of attorney to make the necessary transfer printed on the back, which has been signed in blank by the owner, is not at common law a negotiable instrument, title to which passes by delivery. If obtained feloniously from the true owner, his title ordinarly is not divested upon sale by the thief to a purchaser for value without notice of the theft."

In *American Surety Co.* v. *Cunningham*, 200 Minn. 566, the Court said on page 574:

> "The law of the situs of a stock certificate at the time of its transfer determines the rights of the parties to it. [Citing cases.] Where the situs of the stock certificates at the time of transfer is another

> jurisdiction and no proof is made at the trial as to the law of that jurisdiction, the common law rule applies * * *."
>
> "But the common law rule applies in any case, whether or not the Uniform Stock Transfer Act is in effect in the situs at the time of transfer, to stock certificates issued by a corporation organized in a state where that act has not been adopted."

In *American Surety Co. of New York* v. *Gerold*, 12 N. Y. Supp. (2d Series) 614, the Court said on page 615:

> "Since the stock is that of a corporation organized under the laws of the State of Delaware, which has not adopted the uniform stock transfer provisions of our Personal Property law § 162 *et seq.*, such action is maintainable under common law principles which protect the true owner of a stock certificate against divestment by theft followed by negotiation and transfer to a bona fide purchaser." (Citing cases.)

Even the provisions of the Illinois Uniform Stock Transfer Act would not protect this purchase, for this corporation then was not a purchaser "in good faith without notice of any facts making the transfer wrongful," as the Illinois Act requires (Sec. 422, Chapt. 32, Ill. Revised Statutes).

CONCLUSION.

It is respectfully submitted that substantial error was committed by the United States Circuit Court of Appeals for the Seventh Circuit in its consideration of this case; that the matters herein set out call for the exercise by this Court of its supervisory powers, and that to such end a writ of certiorari should be granted and this Court should review and reverse the said decision and judgment rendered by the United States Circuit Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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